

regard to its additional section 263A costs. Similarly, a taxpayer that adjusts current-year costs by applicable indexes to determine whether there has been an inventory increment or decrement in the current year for a particular LIFO pool must disregard the additional section 263A costs in making that determination.

(B) *LIFO increment.* If the taxpayer determines there has been an inventory increment, the taxpayer must state the amount of the increment in current-year dollars (stated in terms of section 471 costs). The taxpayer then multiplies this amount by the absorption ratio. The resulting product is the additional section 263A costs that must be added to the taxpayer's increment for the year stated in terms of section 471 costs.

(C) *LIFO decrement.* If the taxpayer determines there has been an inventory decrement, the taxpayer must state the amount of the decrement in dollars applicable to the particular year for which the LIFO layer has been invaded. The additional section 263A costs incurred in prior years that are applicable to the decrement are charged to cost of goods sold. The additional section 263A costs that are applicable to the decrement are determined by multiplying the additional section 263A costs allocated to the layer of the pool in which the decrement occurred by the ratio of the decrement (excluding additional section 263A costs) to the section 471 costs in the layer of that pool.

(iv) *De minimis rule for producers with total indirect costs of \$200,000 or less—(A)*

In general. If a producer using the simplified production method incurs \$200,000 or less of total indirect costs in a taxable year, the additional section 263A costs allocable to eligible property remaining on hand at the close of the taxable year are deemed to be zero. Solely for purposes of this paragraph (b)(3)(iv), taxpayers are permitted to exclude any category of indirect costs (listed in § 1.263A-1(e)(3)(iii)) that is not required to be capitalized (e.g., selling and distribution costs) in determining total indirect costs.

(B) *Related party and aggregation rules.* In determining whether the producer incurs \$200,000 or less of total indirect costs in a taxable year, the related party and aggregation rules of § 1.263A-3(b)(3) are applied by substituting total indirect costs for gross receipts wherever gross receipts appears.

(v) *Examples.* The provisions of this paragraph (b) are illustrated by the following examples.

Example 1—FIFO inventory method. (i) Taxpayer J uses the FIFO method of accounting for inventories. J's beginning inventory for 1994 (all of which is sold during 1994) is \$2,500,000 (consisting of \$2,000,000 of section 471 costs and \$500,000 of additional section 263A costs). During 1994, J incurs \$10,000,000 of section 471 costs and \$1,000,000 of additional section 263A costs. J's additional section 263A costs include capitalizable mixed service costs computed under the simplified service cost method as well as other allocable costs. J's section 471 costs remaining in ending inventory at the end of 1994 are \$3,000,000. J computes its absorption ratio for 1994, as follows:

$$\frac{\text{Additional section 263A costs incurred during 1994}}{\text{Section 471 costs incurred during 1994}} = \frac{\$1,000,000}{\$10,000,000} = 10\%$$

(ii) Under the simplified production method, J determines the additional section 263A costs allocable to its ending inventory by

multiplying the absorption ratio by the section 471 costs remaining in its ending inventory:

$$\text{Additional section 263A costs} = 10\% \times \$3,000,000 = \$300,000$$